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September 4, 1992

Ms. Donna Searcy
Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, D.C. 20554

Re: In the Matter of: Price Cap Performance Review For AT&T, CC Docket No.
92-134

Dear Ms. Searcy,

Enclosed herewith for filing are the original and nine (9) copies of MCI Telecommunications Corporation's Comments in the above captioned matter. Also enclosed is a copy of MCI's filing on a computer diskette, with a format consistent with WordPerfect 5.1.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Comments furnished for such purpose and remit same to the bearer.

Yours truly,

Michael F. Hydock
Senior Staff Member
Federal Regulatory Affairs

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In the Matter of:)
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Price Cap Performance Review
For AT&T)
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_____)

CC Docket No. 92-134

Comments of MCI

MCI Telecommunications Corporation (MCI) respectfully submits these Comments in the above-captioned Notice of Inquiry.¹

I. Introduction

MCI supported broad aspects of the Commission's original AT&T price cap proposals. This support was predicated on the belief that competition in the interexchange industry had developed to the point that detailed rate of return regulation for AT&T was no longer necessary, and indeed, could become counter-productive. Price caps appeared to be a reasonable means to protect those ratepayers subject to fewer competitive alternatives from price gouging by AT&T, while at the same time allowing additional Commission resources to be focused on the monopoly local exchange carriers (LECs).

¹ In the Matter of Price Cap Performance Review for AT&T, CC Docket No. 92-134, Notice of Inquiry, (NOI), released July 17, 1992.

In this Notice, the Commission has concluded "that price caps appear to have achieved the goals of reasonable rates, effective incentives for efficiency and innovation, and reduced regulatory burdens."² MCI agrees that performance in the interexchange market has been generally good since the imposition of price caps. However, the credit for good market performance should be placed where it belongs -- on the continuing development of interexchange competition. Price cap regulation by itself has had little or nothing to do with the improved economic performance the Commission accurately describes. Instead, the switch to price cap regulation was made possible by the increasingly competitive environment in the interexchange market.

The Commission notes that "during the first three years of price caps, AT&T's rates in all three price cap baskets have remained below the price cap limits."³ In other words, price caps have not been a binding constraint on AT&T performance. Only the presence of competition can explain this result.⁴

Commission recognition that competition policies are the primary drivers of good performance in the interexchange market is essential to a meaningful review of price caps. Fine-tuning or tinkering with price caps is unlikely to provide significant consumer benefits. The Commission can preserve and promote good economic performance in the

² NOI at ¶ 13.

³ NOI at ¶ 17. As noted below, this experience can be contrasted with LEC price caps, where rates remain at or very close to the ceilings for all services.

⁴ However, as noted below, most of the competitive benefits in Basket 1 have flowed to Reach Out users.

interexchange market primarily by ensuring that competition continues to develop. The steps which MCI believes are necessary are described in Section II.

Another significant MCI concern is that the Commission's apparent misunderstanding of the role of price caps in the interexchange market will affect its judgement of the local exchange carrier price cap experiment. The inapplicability of the AT&T price cap experience to the interexchange market to local exchange carrier regulation is discussed in Section III.

Finally, in Section IV, responses to specific issues raised by the Commission are provided.

II. Steps Necessary to Preserve and Promote the Benefits of Competition in the Interexchange Market

As the Commission determined in the AT&T Dominance proceeding, the interexchange market, while becoming increasingly competitive, is still dominated by AT&T. There are a number of proactive steps the Commission can take to preserve or increase competitive market opportunities. Among these are promoting the evolution of equal access, reducing access charges, and enforcing market rules that reduce opportunities for anti-competitive discrimination by AT&T.

A. Equal Access

The most important single event contributing to the development of interexchange competition in the past decade was the implementation of the court-ordered equal access requirements beginning in 1984. Consumers are still reaping the benefits of this change.

However, as MCI has reminded the Commission many times, Feature Group D or "Dial 1" access was the beginning, not the end of the equal access process. Two significant equal access milestones are yet to be implemented: 800 Number Portability and Billed Party Preference.⁵ If competition and the benefits that competition brings are to continue to grow, then the Commission must ensure that the 800 Database is implemented on schedule and that current consumer and competitive problems are resolved in the Billed Party Preference proceeding.⁶

B. Access Charges

Reasonable and non-discriminatory access charges are essential to continued good performance in the interexchange market. In particular, the Commission is currently reviewing the existing transport rate structure with a view towards making it more consistent with the introduction of a limited amount of competition in the exchange access market. As MCI and others have noted in their comments in the relevant proceedings, a rate structure that is not based on actual costs has the potential to do serious damage to smaller interexchange carriers.⁷ Such a result will reduce competition and the benefits

⁵ In the Matter of Provision of Access for 800 Services, CC Docket No. 86-10, Memorandum Opinion and Order on Reconsideration and Second Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd. 5421, (1991); and In the Matter of Billed Party Preference for 0+ InterLATA Calls, CC Docket No. 92-77, Notice of Proposed Rulemaking, released May 8, 1992.

⁶ Equal access, however, is not a static concept. As technology and market demand change, interexchange carriers may require access to new features and functions in the local exchange. Local exchange carrier obligations and the Commission's responsibility to enforce those obligations will not end with the implementation of the 800 Database and Billed Party Preference.

⁷ In the Matter of Transport Rate Structure and Pricing, CC Docket No. 91-213, Comments of MCI Telecommunications Corporation, filed November 22, 1991, pp. 2-4.

that competition brings. Moreover, the future structure of tariffed expanded interconnection for special and switched access has the ability to reward AT&T with significant -- and unearned -- access cost advantages derived from its Shared Network Facility Access and Condominium agreements with the LECs.⁸ Continued focus on the competitive effects of access charge rate structures is essential.

Removing waste and misallocated expenses from the access charge revenue requirement is also important. A number of necessary separations changes, including the need to reduce interstate marketing expenses, have been identified.⁹ In addition, the Commission should look for opportunities to move a greater portion of the carrier common line revenue requirement out of the interexchange revenue requirement. The resulting increase in economic efficiency will benefit both interexchange carriers and their customers.

C. AT&T Market Rules

As MCI argued during both the price cap and the AT&T deregulation proceedings, the most critical competitive safeguards in the interexchange market are rules requiring AT&T to make its services generally available, subject to resale and unbundled. These rules, if properly enforced, limit AT&T's ability to price anti-competitively or otherwise leverage its remaining market power to reduce competition.

⁸ In the Matter of Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Reply Comments of MCI Telecommunications Corporation, filed September 20, 1991, pp 16-27.

⁹ In the Matter of 1990 Annual Access Tariff Filings, MCI Petition to Reject, or in the Alternate to Suspend and Investigate, filed April 27, 1990.

Although many of the controversies involving application of these rules have taken place outside the context of price cap regulation, their continued enforcement is necessary to ensure competition and the benefits that competition brings. In short, the strong market performance in evidence since the adoption of price caps is the result of the application of market rules to AT&T services. As more and more services are allowed to be offered without these safeguards, the benefits of competition will be correspondingly threatened.¹⁰

III. The Inapplicability of the AT&T Price Cap Experience to the Exchange Access Market

As noted in the Introduction, competition, not price caps, is primarily responsible for good economic performance in the interexchange market. MCI is concerned that in giving the credit to price caps, the Commission may mistakenly apply the analysis to the exchange access market. In fact, price caps have not improved performance in the access market.

The results of the most recent Annual Access Charge filings amply illustrate the problems with LEC price caps. The filings of the price cap carriers were riddled with controversy. Several carriers reached the upper adjustment levels with apparent ease while others appeared to take advantage of the lower adjustment levels to help pay for corporate

¹⁰ These issues are being litigated in several Commission Complaint and Tariff proceedings. See, e.g., In the Matter of AT&T Communications Revisions to Tariff F.C.C. No. 15; and, In the Matter of Competition in the InterLATA Marketplace, CC Docket No. 90-132.

restructurings.¹¹ Individual LEC filings for new services or service restructurings continue to create problems for the Commission and for access customers. The fact is that price caps neither change the fundamental nature of the LEC monopolies, nor do they significantly change the incentives the LECs have to exploit those monopolies to the detriment of their customers.¹² Without meaningful competition, no incentives exist for the LECs to price below their caps.¹³

IV. Responses to Specific Issues Raised by the Commission

The Commission raised several specific issues for Comment by the parties. MCI's responses to these issues appear below.

A. Issue 1: Should the AT&T price cap regulations be continued after June, 1993?

Provided that 800 Number Portability is proceeding on its current schedule and the Commission satisfactorily resolves Billed Party Preference issues, there is no reason to

¹¹ In the last annual access tariff filing several LECs (Ameritech, Bell Atlantic, BellSouth, Nevada Bell, and United) earned at the upper adjustment band. Several other LECs, such as NYNEX, SNET and selected study areas of GTE, used the opportunity provided by the lower adjustment bands to raise the ceilings. As Exhibit 1 indicates, all the Regional Bell Operating Companies feature Actual Price Indices (APIs) for Traffic Sensitive and Special Access Baskets that are virtually identical to their Price Cap Index (PCI). Only one study area of GTE shows any indication that the LECs are pricing below the maximum allowed under price caps. Obviously the absence of any true competition for the larger LECs is an impediment to below cap prices under a price cap regime. There is simply no incentive to price below the maximum allowable rates.

¹² In the Notice the Commission claims that accurate cost allocation is one of the benefits of price caps. [Notice at ¶ 6] Of course, with respect to AT&T, which now faces competition for most of its services, cost allocation is no longer a major concern. However, cost allocation is still a problem for the LECs. The current LEC price cap plan in no way reduces incentives for inaccurate cost allocation by the LECs.

¹³ See, note 11 supra.

continue price cap regulation of AT&T. Enforcement of residual market rules should be sufficient to protect consumers and competition against abuse of AT&T's dominant position. However, as discussed in the answer to issue five, there may be some justification for retaining a price cap for standard MTS services.

B. Issue 2: Should the formulas for computing AT&T's price cap indices be changed?

If price caps are retained, MCI knows of no basis for changing the formulas. One of the dangers of retaining price caps as competition continues to develop is that the formulas will constrain efficient price changes by AT&T.

C. Issue 3: Should the productivity factor used to compute the AT&T price cap indices be changed? In addition or in the alternative, should a one-time change in AT&T's price cap index be required?

If price caps are retained, MCI knows of no basis for changing the productivity factor or adjusting the price cap indices. As the Commission notes, market performance is generally good and prices are below the existing ceilings anyway. Changing the ceilings or the productivity factor would likely lead to inefficient pricing.

D. Issue 4: Should the Commission increase monitoring of AT&T's network reliability and service quality?

MCI is unaware of any reason to increase the monitoring of AT&T's network and service quality. As the Commission has pointed out, AT&T has no incentive to allow its

network performance and quality to diminish.¹⁴ Rather, the marketplace serves as the impetus for AT&T, as well as for all other interexchange competitors, to maintain the highest standards of network quality. Moreover, existing reporting mechanisms established within Docket No. 91-273, the Commission's own investigative reports, and the ongoing work of the Network Reliability Council will complement the existing marketplace incentives for service quality.

E. Issue 5: Should the Commission change AT&T's Basket 1?

As MCI noted in its comments in CC Docket No. 87-313, one of the justifications for caps on residential service is to ensure that customers in non-equal access areas or low usage customers who are unlikely to entertain competitive alternatives receive some of the benefits of competition. If price caps are retained, it may make sense to remove Reach-Out from Basket 1.

It appears that AT&T has priced further below its cap for former Basket 3 services, and to a lesser degree in the least competitive areas of Basket 1 and 2.¹⁵ For example, as of July 1, 1991, the former Basket 3 actual price index was 1.44 percent below the price cap index, while Basket 1 and Basket 2 actual price indices were 0.53 percent and 0.43 percent below their price cap indices, respectively. During the price cap period, the sharpest rate reductions within Basket 1 have occurred in the service band for Reach Out America, with the index dropping from 97.1 to 86.9, or 10.5 percent, while the overall

¹⁴ NOI, at ¶ 25.

¹⁵ Public Notice, DA 92-1206, released September 1, 1992, Chart 1.

residential index fell by only 4.4 percent. This behavior appears to reinforce MCI's premise that competition, not price caps per se, has driven the downward movement of AT&T's pricing. Moreover, this may argue for a re-examination of the composition of Basket 1 to insure that consumers of AT&T's basic MTS schedule receive a fair proportion of the benefits of competition.

V. Conclusion

AT&T price caps were a valid response to increasing competition in the interexchange market. As competition continues to develop, it is appropriate for the Commission to modify or eliminate price caps. However, it would be a mistake to attribute the benefits of competition to price cap regulation. The Commission's primary public policy objective for the interexchange market should be to take the proactive pro-competitive steps described in these Comments.

Respectfully submitted,

MCI TELECOMMUNICATIONS
CORPORATION

A handwritten signature in dark ink, appearing to read "Michael F. Hydock", is written over the typed name.

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Dated: September 4, 1992

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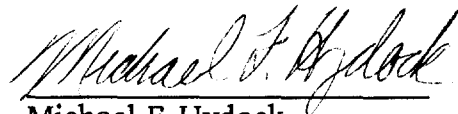
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 SNCT - Southern New England Tel.
 SWTR - Southwestern Bell
 USTR - US West

STATEMENT OF VERIFICATION

I have read the foregoing, and to the best of my knowledge, information, and belief there is good ground to support it, and that it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on September 4th, 1992.

A handwritten signature in cursive script, reading "Michael F. Hydock", written over a horizontal line.

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CERTIFICATE OF SERVICE

I, Laura Johnson, do hereby certify that copies of the foregoing MCI Filing were sent via first class mail, postage paid, to the following on this 4th day of September, 1992:

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